

May 18, 1994

**FDIC Legal Staff's Interpretive Guidelines on the Insurance of Revocable Trust Accounts (Including Living Trust Accounts)**

This memorandum describes in general terms the extent of deposit insurance coverage available to accounts containing the funds of revocable trusts. A revocable trust account is an account owned by an individual -- the trust settlor or grantor who establishes the trust -- which shows an intention that the funds will "belong to" a designated beneficiary upon the account owner's death. Throughout this memorandum, examples of the most common trust provisions are given to illustrate the operation of the various insurance rules.

Prior to the discussion of the insurance rules, however, two points should be mentioned. First, while the legal opinions provided here represent the current thinking of the FDIC Legal Division staff, they are not legally binding on the FDIC or its Board of Directors. Because the FDIC does not provide any kind of analysis for individual trusts, however, this memorandum is the only form of FDIC legal opinion that an individual depositor can receive.

Second, what may seem to be only a slight difference between a trust provision cited here and a trust provision appearing in a given depositor's trust document may lead to a vastly different result in the amount of insurance coverage permitted. For this reason, it would be best for depositors to use this memorandum as a guide only, and to consult an attorney specializing in trusts (perhaps the attorney who drafted the given trust) in order to determine the insurance coverage for that particular trust.

The FDIC's present regulation on the insurance of revocable trust accounts follows:

a) General rule. Funds owned by an individual and deposited into any account commonly referred to as a tentative or "Totten" trust account, "payable-on-death" account, revocable trust account, or similar account evidencing an intention that upon the death of the owner, the funds shall belong to such owner's spouse, or to one or more children or grandchildren of the owner, shall be insured in the amount of up to \$100,000 in the aggregate as to each such named beneficiary, separately from any other accounts of the owner or the beneficiaries. Such intention must be manifested in the title of the account using commonly accepted terms such as, but not limited to, "in trust for", "as trustee for", "payable on death to," or any acronym therefor, and the beneficiaries of the account must be specifically named in the deposit account records of the insured depository institution. The settlor of a revocable trust account shall be presumed to own the funds deposited into the account. 12 C.F.R. § 330.8(a).

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This regulation applies to revocable trust accounts held by all insured depository institutions, both banks and savings and loan associations (hereafter “savings associations”).

It is important to note that the special insurance coverage provided by the regulation quoted above depends, first of all, upon the proper titling of the trust accounts, and then, upon the listing of the trust’s beneficiaries by name in the deposit account records of the insured depository institution.

As far as account titling is concerned, the terms which must be used are said to be “commonly accepted terms such as, but not limited to, ‘in trust for,’ ‘as trustee for,’ ‘payable-on-death to,’ or any acronym [abbreviation] therefor” (emphasis added). Thus, if the title of a trust account suggests that a trust is involved, that title will usually be acceptable. For instance, a trust account entitled the “Jones Family Trust” or the “Jones Family Revocable Trust” would meet the proper titling requirement even though these titles are not precisely in the form of “in trust for,” “as trustee for,” or “payable-on-death to.”

The next requirement is that the trust’s beneficiaries be “specifically” listed in the insured depository institution’s “deposit account records.” The “specifically” means that the beneficiaries must be listed by name -- for example, Anne Jones, Tommy Jones -- not merely by the class to which they belong -- that is, the requirement is not met by listing the beneficiaries merely as “my children.” As for the “deposit account records,” these are defined as “account ledgers, signature cards, certificates of deposit, passbooks... and other books and records of the insured depository institution, including records maintained by computer, which relate to the insured depository institution’s deposit taking function.” 12 C.F.R. 330.1(d). For most purposes, perhaps the signature card and the certificate of deposit are the best places for listing one’s beneficiaries.

### Insurance Coverage of Simple Trusts (Trusts Established without Written Trust Documents)

In order to understand how the above regulation works, one must first know a bit about the FDIC’s insurance rules in general. Under the FDIC’s rules, deposits in a bank or savings association are insured according to the “right” or “capacity” in which they are held. The terms “right” and “capacity” refer to the manner in which the accounts are held, such as jointly-owned accounts, trust accounts, or individually-owned accounts. All accounts (including savings or checking accounts and certificates of deposit) owned by a depositor in the same right and capacity within the same insured institution will be added together and insured for up to \$100,000. (Of course, a depositor cannot be insured for more than he holds in all such accounts.) Deposits maintained in different rights and capacities are separately insured for up to \$100,000. What the rule

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quoted above means is that, if a revocable trust beneficiary is the spouse, child or grandchild of the trust owner, that may entitle the trust owner, or “settlor,” to even more insurance coverage than he would otherwise get -- up to \$100,000 times the number of settlors living when the depository institution goes into default times the number of qualifying beneficiaries (spouse, child, or grandchild of the settlor) then living who have a vested interest in the trust upon the death of the last settlor to die. (Of course, if the insured institution goes into default before the death of the last settlor to die, the only qualifying beneficiaries who might have a vested interest are those who are alive at the time of the institution’s default.)

For instance, assume that, at the same insured depository institution, a husband and a wife co-own a joint account and that each also owns a separate trust account with one beneficiary, their daughter (who will receive a trust’s funds outright as soon as the settlor of that trust dies). In this case, the FDIC would say that the joint account is being held in a different right and capacity from either of the trust accounts, so the joint account would be separately insured from the trust accounts for up to a maximum of \$100,000. The FDIC would consider the mother’s trust for the benefit of her daughter to be held in a different right and capacity from the father’s trust for the same daughter, because the trust owner’s are different. Then, too, because the beneficiary is the child of each of her parents, and because it is each parent’s intentions that the trust funds “belong to” their daughter as soon as that parent dies, each of these trust accounts will be separately insured for up to \$100,000. Thus, given the parents’ joint account and the two trust accounts, there will be a maximum of \$300,000 of insurance coverage for these accounts. Note, however, that if the father owned two trust accounts, at the same institution, with each account having the same beneficiary, his daughter, these two accounts would be viewed as being held in the same right and capacity, and so would be added together and insured for up to \$100,000 only. (And this would be so even if one account was a simple payable-on-death account -- Father POD to Daughter -- and the other trust account was governed by a lengthy revocable trust document, in which the father also named several other beneficiaries, including his daughter. In this case, the amount of the daughter’s interest in the revocable trust would be added to the payable-on-death account held for her benefit, and that amount insured for up to \$100,000.)

The maximum insurance of \$100,000 applies to each insured depositor holding funds in a given capacity in each insured depository institution, without regard to the deposits held by that depositor in any other separately chartered institution. For example, if Mother held \$100,000 in a payable-on-death account for Son at Bank A, and Mother also held \$100,000 in a second payable-on-death account for Son at Bank B, the FDIC would insure each account separately for \$100,000; it would not add the two accounts together and insure the \$200,000 total amount for only \$100,000. However, if a bank

(or savings association) has one or more branches, the main office and all branch offices are considered one bank (or savings association). Thus, all accounts owned by a depositor in the same right and capacity within the main office and branches of the same bank (or savings association) will be added together and insured for up to \$100,000.

#### The Insurance Coverage of More Difficult Revocable Trust Accounts

In examining this subject, it is important to remember that a revocable trust account is an account owned by an individual -- the trust owner or settlor or grantor who establishes the trust -- which shows an intention that the funds will belong to a designated beneficiary upon the account owner's death. A revocable trust -- sometimes called a "living" or "inter vivos" trust -- is a trust which comes into being while the settlor is living, as distinguished from a trust that is created after he has died, by the terms of his will. A revocable trust can be revoked by the settlor, usually until his death.

In order to qualify for the special insurance coverage provided to revocable trust accounts by 12 C.F.R. § 330.8, the following two conditions must be met upon the death of the last settlor to die:

- (1) there must be one or more qualifying beneficiaries to benefit from the trust (that is, one or more of the beneficiaries upon the death of the last settlor must be the spouse, child or grandchild of a settlor); and
- (2) a qualifying beneficiary, at the death of the last settlor, must have a vested or non-contingent interest in the trust (such that the funds might be said to "belong to" the beneficiary). This "vested or non-contingent interest" for revocable trusts is defined far differently from the "vested or non-contingent interest" for irrevocable trusts and should not be confused with the irrevocable trust's definition.

The first condition -- that, upon the death of the last settlor, there be one or more qualifying beneficiaries of a settlor to benefit from the trust -- is not very difficult to satisfy. The term "children," after all, includes all natural-born children, adopted children and step-children of the settlor, and "grandchildren" include all natural-born, adopted children and step-children of any of the settlor's children.

The second condition, however -- that a qualifying beneficiary must have a vested or non-contingent interest in the trust -- is much more difficult to satisfy.

The FDIC defines a “vested interest” in the context of a revocable trust as:

- (1) an interest to which no defeating contingency is attached; AND
- (2) an interest where the person holding it has already been born, and his identity ascertained upon the death of the last settlor to die (or upon the earlier default of the insured depository institution); AND
- (3) an interest where, no later than upon the death of the last settlor to die, the trustee is instructed to set aside a share of the trust principal for this particular beneficiary (even if that share might later change in size, for example, when another grandchild of the settlor is born after the death of the last settlor, but before the funds are scheduled to be finally distributed; note, however, that this grandchild, because he was born after the death of the last settlor, would not be considered a qualifying beneficiary because of requirement (2)); AND
- (4) an interest where the beneficiary either receives an outright distribution of his share of the trust principal upon the death of the last settlor OR can invade the principal of his share to an unlimited extent at his or her demand from that time on OR where the beneficiary will eventually take his share outright, provided that he survives for a given number of years or to a certain age, or, if he does not so survive, provided that his share in the trust will pass to his estate or his heirs at his death.

Assuming that a given trust fulfills all of the above requirements, the following example shows how an account holding the funds of that trust would be insured.

#### The Basic Operation of the Rule

Suppose that two settlors, a husband and wife, establish a revocable trust for the benefit of the survivor of them and their four children. Upon the death of the first settlor to die, the trust is split into a marital trust for the surviving spouse and a family trust for the children. The trust defines how much is to go into each of these sub-trusts and provides that the surviving spouse will be able to invade the principal of her trust to an unlimited extent during her life, and, if she wishes, to dispose of the rest (if any) of the marital trust by will. The trust also provides that, upon the death of the last settlor to die, the trustee is to set aside a share of the family trust for each of the settlors' children then living. Each child is to receive his share outright when he attains 21 years of age. If a child dies before reaching 21 years of age, his share of the trust will go to his estate or heirs.

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What would be the insurance coverage of such a trust? It is important to remember that the amount of insurance coverage can change according to who is alive when the bank or savings association fails and according to whether the trust then in operation is a revocable or irrevocable trust.

While both the husband and the wife are alive, the trust outlined above is revocable, so one would apply the insurance regulation at 12 C.F.R. § 330.8. Looking to the number of qualifying beneficiaries (here, children) who will have a vested interest upon the death of the last settlor to die, one finds the four children. Thus, if the depository institution should fail while both spouses are alive, the trust would be insured for a maximum amount equal to --

The number of settlors then living (2) times the number of qualifying beneficiaries then living (4) times \$100,000 = \$800,000.

Upon the death of the first spouse to die, the trust remains revocable (because the surviving spouse still has the power to revoke it), and the rules for revocable trusts continue to apply. Once again, the qualifying beneficiaries who will have a vested interest in the trust upon the death of the last settlor to die are the four children. Thus, if the depository institution should fail when the surviving spouse is alive, the trust would be insured for a maximum amount equal to --

The number of settlors then living (1) times the number of qualifying beneficiaries then living (4) times \$100,000 = \$400,000.

Upon the death of the surviving spouse -- that is, upon the death of the last settlor to die -- the trust usually becomes irrevocable (because usually only the settlors have the power to revoke the trust and once they have died that power is gone). Because the trust is irrevocable, one must apply the regulation for irrevocable trusts. According to that regulation, in order for a beneficiary's interest to receive separate insurance coverage, the beneficiary need not be only the spouse, child, or grandchild of the settlor. Instead, the rule for irrevocable trusts adds together all of the "non-contingent trust interests" of the same beneficiary that are created by the same settlor (in one or more irrevocable trusts) and insures that beneficiary's total interest which is derived from that settlor for up to \$100,000, which such coverage remaining separate from that provided for other accounts maintained by the settlors, trustees or beneficiaries of the irrevocable trust (or trusts) at the same insured depository institution. In addition, each trust interest in any irrevocable trust established by two or more settlors is deemed to be derived from each settlor pro rata to his or her actual contribution to the trust. Meanwhile, all interests of an irrevocable trust which are deemed to be contingent are added together and insured for up to \$100,000, separately from the coverage for non-contingent interests.

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The FDIC defines a “non-contingent trust interest” as it applies to irrevocable trusts as a trust interest capable of determination without evaluation of contingencies except for those covered by the present worth or life expectancy tables of the Internal Revenue Code. 12 C.F.R. §330.11.

Apply the irrevocable trust rule to our example, one finds that there are four living beneficiaries with non-contingent interests upon the death of the last settlor. Assuming that each settlor made equal contributions of \$100,000 to the trust for each of the four children, then each child's interest from his father would be insured for up to \$100,000, and each child's interest from his mother would be insured for up to \$100,000 -- for a total of \$800,000 in insurance coverage for the trust as a whole. (As there are no contingent interests in our example, it is not necessary to deal with the second part of 12 C.F.R. § 330.11.)

In order for the special insurance coverage of the revocable trust regulation, Section 330.8, to be triggered, upon the death of the last settlor there must be at least one qualifying beneficiary (a spouse, child or grandchild of a settlor) and that qualifying beneficiary must have a vested interest in the trust. One of the requirements of a vested interest is that there is no condition attached to it which would render it contingent. Because such conditions, or “defeating contingencies,” have a drastic effect on the insurance coverage of a trust, it is important to examine them more closely.

### The Effect of a Defeating Contingency

Suppose that a settlor establishes a revocable trust for his wife and three children. Upon his death, should his wife survive him, the trust is split into a marital trust for the wife and a family trust for the children. His trust defines how much is to go into the marital trust and states that, upon his death, the family trust is to be divided into equal shares for his children then living, and immediately distributed outright to those children. However, his trust also states that, if his probate estate should prove insufficient to pay for all of the legacies he makes in his will, his executor can make his trustee use the funds in the family trust to pay for those legacies. This clause in the trust has the effect of making the children's interests contingent, and thus ineligible for the special insurance coverage provided by 12 C.F.R. §330.8. As a result, those funds attributable to the children's interests would be insured like the settlor's individually-owned funds; that is, they would be aggregated with any individually-owned funds held by the settlor in the same institution, and the entire amount insured for up to \$100,000. (If the settlor holds no individually-owned funds in that institution, those funds attributable to the children's interests would still be added together and insured for up to \$100,000.)

A similar “defeating contingency” occurs where the trust gives the settlor a power of appointment by will over the funds in the trust. By exercising this power of appointment, the settlor of the trust can literally take away what the trust has promised

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to give to his beneficiaries. Suppose that, in the trust above, where the beneficiaries are the wife and three children, the trust gives the settlor a general power of appointment by will over the trust funds. Because the settlor might choose to leave the trust funds to someone totally other than his wife and children -- for example, his brother -- this general power of appointment renders the interests of the trust beneficiaries contingent. However, if the settlor's power of appointment limits him to leaving the trust funds to one or more of his wife and three children -- that is, to one or more of a group of people all of whom are qualifying beneficiaries -- this limited power of appointment would not be construed as a defeating contingency. Instead, the interest of that entire group of possible beneficiaries would be separately insured for up to \$100,000. But if that group should happen to contain even one nonqualifying beneficiary -- say, the settlor's nephew -- this limited power of appointment would be treated as a defeating contingency.

Another "defeating contingency" occurs when the trust states that a beneficiary must survive the settlor for a given period of time before his trust share is established. (Please note that requiring a beneficiary to survive the settlor for a single moment before the beneficiary's trust share is established is not a defeating contingency.) Suppose that a husband sets up a very simple trust for his wife. Upon his death, he wants everything in the trust to be distributed to his wife outright but only if his wife survives him for nine months. This condition means that, upon the death of the settlor, the wife's interest in the trust is only contingent, since she will have a vested interest in the trust only if she survives her husband for nine months. Once an interest is vested, however, it is permissible to say that a beneficiary will not receive an outright distribution of the funds until he reaches a given age or until he has survived for a given amount of time (for example, until a child has attained majority). Holding off the outright distribution of funds in this way does not prevent a qualifying beneficiary with a vested interest from receiving the special insurance coverage of Section 330.8, provided that, if such a beneficiary does not survive for the given amount of time or reach the given age, the trust provides that his share will go to his estate or his heirs.

There is a defeating contingency where a beneficiary is to receive payments of income and/or principal only at the discretion of the trustee (where the beneficiary is not the trustee) -- because a given beneficiary has no right to the funds, and may never receive anything. Likewise, where the beneficiary is to receive payments only once he or she has received a college degree, or married, or upon some other condition, each of these is a contingency that will defeat the special insurance coverage of the beneficiary's trust interest.

But there are some contingencies which do not defeat the separate insurability of a beneficiary's trust interest. For instance, a condition that the beneficiary must survive the settlor for only a moment in order to benefit from the trust; a condition that inheritance, estate and other death taxes, last illness and funeral expenses, the decedent's debts and administrative expenses relating to the settlor's estate must be

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paid from the trust; a condition that attorney's fees, accountant's fees, and other expenses of operating the trust must be paid from the trust; and a condition that the marital trust (or family trust) will not be formed unless a spouse (or issue) survives the settlor for only a moment -- all of these conditions are viewed as such expected parts of trusts that they can appear in a trust without being held to prevent the beneficiary from having a vested interest in the trust, provided the beneficiary does have a vested interest.

### What Happens to the Interests of Nonqualifying Beneficiaries?

The above sections have dealt with how the interests of qualifying beneficiaries with vested interests are insured, where a beneficiary is said to be "qualifying" if he is the spouse, child or grandchild of the trust settlor. Now this section will show what happens when a settlor names one beneficiary who is qualifying and one who is not.

Suppose that two trust owners or settlors -- assume that they are husband and wife -- establish a revocable trust of \$400,000 for their son and their nephew. In this case, their son is a qualifying beneficiary but their nephew is not. Unless stated otherwise in the trust, it is presumed that the husband and wife have contributed equal sums to the trust and that the beneficiaries will share equally in it. This means that the husband is viewed as having contributed \$100,000 for the benefit of his son and \$100,000 for the benefit of his nephew, and that the wife is viewed as having contributed the same amounts for each beneficiary. Since the nephew is not a qualifying beneficiary, the \$100,000 representing his beneficial interest derived from the husband will be combined with any individually-owned funds of the husband that are held in the same institution, and the total amount will be insured for up to \$100,000 only. (If the husband holds no individually-owned funds in that institution, the nephew's beneficial interest derived from the husband will still be insured for up to \$100,00.) In the same way, the \$100,000 representing the nephew's beneficial interest derived from the wife will be combined with any individually-owned funds of the wife and insured in the aggregate to \$100,000. As to the remaining amounts -- the \$100,000 held by the husband for the benefit of his son and the \$100,000 held by the wife for the benefit of this same son---- each amount will be separately insured for up to the maximum amount of \$100,000, or a total of \$200,000 in insurance coverage for their son's interest in the trust.

### An Exception to the General Rules -- Insurance Coverage When a Husband and Wife Together Establish a Trust with One or Both of Them as the Sole Beneficiary or Beneficiaries

A special situation is the revocable trust established by a husband and wife solely for their own benefit (or for the benefit of only one of them). In this case, where the husband and wife are co-settlors and co-beneficiaries, and where the survivor takes everything on the death of his spouse, the FDIC considers this trust the equivalent of a joint account with right of survivorship. Such a trust account will be insured for up to

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\$100,000 only, according to the FDIC's rules, and, while both spouse are alive, it will be aggregated together with any joint accounts of the husband and wife and the entire amount insured for up to a maximum of \$100,000, as if the trust account were, in fact, a joint account. This rule applies to trusts in the form of (1) husband (H) and wife (W) in trust for H and W, (2) H and W in trust for H, and (3) H and W in trust for W. With these husband-and-wife accounts, as with other revocable trust accounts, the interest of the qualifying beneficiary must be vested upon the death of the last settlor and there must be no defeating contingencies.

However, a trust in the form of H in trust for W or W in trust for H is still eligible for the special insurance coverage provided by Section 330.8, provided that the other requirements of that section are met. Thus, a simple payable-on-death account in the form of H in trust for W would be separately insured for up to \$100,000, and a similar payable-on-death account in the form of W in trust for H would also be separately insured for up to \$100,000, for a total of \$200,00 of insurance coverage.